



## Chairman's Statement

I am pleased, on behalf of Huali Holdings (Group) Limited ("the Company") and its subsidiaries ("the Group"), to present to all shareholders the operating results and Annual Report of the Group for the year ended 31 December 2006, and would like to express my sincere gratitude to all shareholders and all the staff.

### FINANCIAL PERFORMANCE

The Company was successfully listed on The Stock Exchange of Hong Kong Limited (the "Stock Exchange") on 2 November 2005. For the year ended 31 December 2006, the Group's turnover was RMB696 million, representing an increase of 5.0% over 2005. Total assets amounted to RMB620 million, and total equity amounted to RMB338 million.

### BUSINESS REVIEW

The Group faced many challenges in the year of 2006. Since raw material prices, energy prices, labour costs and interest rates have been rising continuously on different extents, the competition in the industry has been increasingly intensive. Paper packaging companies have been facing the difficulties of higher cost and lower gross profit margin. However, under the joint efforts of the staff, the Group still managed to achieve a business growth through enhancing internal management, building a new factory and expanding the market, which laid a solid foundation for the Group's long term development.

The Group has focused on producing middle to high grade paperboard and cartons and other packaging products, with the clientele being mainly medium and large sized enterprises. In the previous year, the Group offered customers a more comprehensive range of higher quality products and services, through enhancing the quality of products and expanding product range. Meanwhile, the Group puts great efforts on market exploration, and strengthened market sales. During the reporting period, the Group's customer base continued to expand, with a growth in the number of customers to about 650, representing a 9% increase over the same period of last year.

In the past year, the Group implemented a number of measures in order to strengthen internal management, control cost and enhance market competitiveness. To cope with the increase in raw material prices, the Group established a unified purchasing network by capitalising on its branding edge, so as to centralise the purchase of raw materials and major equipment for its subsidiaries. By enlarging the scale of purchase, the Group enhanced its bargaining power in order to control the cost more effectively. In light of the rising electricity price, the Group saved costs by using electricity during off-peak period instead of peak hours, which enjoyed lower charges. Meanwhile, the Group continued to strengthen its management on accounts receivable and inventory in order to lower the capital cost. The Company phased in an Enterprise Resources Planning ("ERP") system at its subsidiaries, in order to provide reference and analysis tools for the management's strategic decision.



## Chairman's Statement

The Group completed two acquisitions during the year of 2006 (details of which had been set out in the announcement of the Company dated 27 January 2006), bringing the total number of manufacturing subsidiaries which are wholly-owned or controlled by the Group to six.

Currently, the Group has established its sales network covering the Pearl River Delta, Yangtze River Delta and North-east area in the People's Republic of China (the "PRC"). In 2006, the new factory in Anhui began operation successfully after construction of the plant and purchasing and testing of production equipment, laying a solid foundation for the Group's business expansion in 2007 and enhancing its competitive advantage in the industry.

### PROSPECTS

Looking ahead in 2007, we expect the cost of raw materials will still be in an uptrend. As a result, the Group will continue to strengthen internal management and production flow control as well as fully implement the ERP system in all manufacturing subsidiaries, so as to maintain stable production costs.

The Group will put greater effort on market exploration, increasing its market share of high valued-added products such as colour-printed materials and enhancing the capability of new product development. At the end of 2006, the factory in Shanghai has procured a large format offset colour printing press from Germany. The press will be put into operation in April 2007, helping the Group to expand its colour-printing business in Eastern China.

The Company will utilise its new factory to increase its income. With the new factory in Anhui successfully put into operation in 2006, a production line of paperboard in Anhui Huali Packaging Company Limited (安徽華力包裝有限公司) ("Anhui Huali") will commence operation in April 2007.

The Group signed an agreement on 19 March 2007 to acquire the land use right of a piece of land located in Huizhou, Guangdong Province, the PRC, on which a new factory is intended to be built for expanding the production capacity. The Group may also consider relocating the operation in Shenzhen, the PRC to the new production base.

With a steady growth in the economy and increasing consumption power in China, the demand for environment-friendly and light corrugated paper packaging will continue to increase, which will create great potential for the development of the Group. Meanwhile, higher raw material prices and the increasingly intensive market competition have presented challenges to the Group. The management believes that, given the Group's experience of over 20 years in the industry, its high quality products and services, its advantageous strategic planning as well as its expanding customer base, the Group will be in a favourable competitive position and endeavours to bring long-term and steady returns to the shareholders.



## Chairman's Statement

### APPRECIATION

I, on behalf of the board of directors, hereby express our most sincere thanks to the management team and all the staff for their efforts and contributions made in the development of the Group. I also take this opportunity to thank all shareholders and business partners for their confidence and support to the Group.

**Zheng Fan**

*Chairman*

Hong Kong, 27 March 2007